

BY PAUL R. OSBORNE, CPA, CPO, AMLP, AND ALAN S. ABEL, CPA, CFE

Important Considerations for Retaining Qualified BSA/AML Auditors

INCREASINGLY, federal examiners criticize financial institutions for inadequate independent testing of their Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance programs. As a result of examiners declaring many audits insufficient because of an auditor's lack of expertise, financial institutions are learning the hard way that penny-wisdom may lead to pound-foolishness when selecting outside auditors to perform independent testing. Authors Paul Osborne and Alan Abel discuss how financial institutions can avoid such problems by focusing on several critical issues when hiring outside auditors.

For several years, the independent testing—or auditing—of BSA/AML compliance programs has been cited as one of the most common deficiencies found in bank BSA examinations. As repeatedly reflected in examination findings and harsh enforcement actions, inadequate audits prompt examiners to question management's judgment in failing to assess and manage risk effectively. Examiners thus find themselves with further reasons to dig deeper during a scheduled BSA examination.

Driven by the independence requirement, institutions frequently turn to outside auditors but might retain the wrong auditors for their needs. Decisions based solely or primarily on price can leave an institution with an auditor who lacks the requisite expertise or does not follow any standards when performing the audit.

Standards for BSA/AML Audit Procedures

Notwithstanding the information provided in the Federal Financial Institutions Examination Council (FFIEC) *BSA Examination Manual*, no industry standards exist for performing BSA/AML audits. Standards for these engagements fall largely within the realm of “best practices,” with many variations on what that actually means. A

financial institution must devise its own expectations for audit procedures and evaluate potential auditors' proposals critically and with an eye on those expectations. As part of its due diligence, a financial institution should compare proposals “apples-to-apples.” For example, a financial institution could compare the proposed sample sizes of the various candidates when deciding which auditor to choose.

Qualified auditors articulate their own thorough standards in their proposals. Auditors who apply robust standards that have been developed and tested over time generally submit substantive and detailed proposals demonstrating their knowledge and experience. These proposals show that the auditor understands the financial institution's business processes and controls; management information systems; regulatory expectations; examination, audit, and compliance history; and other essential components of the BSA/AML program that should shape the audit program.

The Potential for Scope Creep

Proposals should explicitly define the audit's scope. Unless scope is clear to all parties from the start, management and the audit committee might have varying and misleading expectations about the

audit. The audit's scope should be based on a variety of factors, including the *BSA Examination Manual*; reports and findings from previous examinations; prior independent reviews or audits; mitigating factors for risk; the financial institution's overall risk profile; the BSA/AML risk assessment of its products, services, geographies, and customers; the nature of the control environment; and the effectiveness of appropriate business processes and controls.

Sample sizes are an important consideration. A potential auditor's low proposed price might indicate that the auditor neither possesses nor contemplates sufficient resources to test appropriate sample sizes. A qualified auditor bases the respective sample sizes on a number of important factors, including the volume and frequency of transactions, such as foreign and domestic wire transfers; reports filed, such as currency transaction reports (CTRs) and suspicious activity reports (SARs); the number of high-risk customers and their related transactions; the number of monetary instruments sold for cash during a particular period; the overall systems for capturing all transaction information for customers to identify potentially suspicious activity; and other similar factors.

The financial institution should also evaluate an auditor's proposed scope from the perspective of the examiners. According to the FFIEC manual, the specific examination procedures required for an institution depend in part on the quality and quantity of the institution's independent testing or audit. Importantly, the examiners will consider the audit's scope, effort, quality of work, and report in determining the



extent to which they can comfortably rely on the auditor's work. They will identify those areas warranting greater or less scrutiny and note when expanded examination procedures are required. A well-scoped audit will significantly facilitate the examination process.

Professional Qualifications and Competencies

Properly executed, BSA/AML compliance is an enterprise-wide endeavor. Everyone—from tellers to the board of directors—has a role to play, and examiners expect an institution's audit to cover the entire enterprise. The audit must consider all subsidiaries, lines of business (LOBs), and functional areas. To determine the appropriate audit coverage for each LOB or functional area, including sample sizes based on the level of risk for each, the auditor must have a keen understanding of the financial institution's business, business processes, and controls.

Some auditing firms tout their representatives' backgrounds in law enforcement or academia, but these individuals often possess neither optimal experience in accounting and compliance auditing nor expertise in business processes and controls. The BSA/AML audit is not an area in which a financial institution can afford to invest in on-the-job training. Examination reports, memoranda of understanding, and harsh enforcement actions frequently state that management should dedicate the necessary

resources to ensure that the BSA/AML department has the requisite skills and qualifications to manage the institution's BSA/AML program.

Standards for Reporting

As with the procedures for conducting an audit, no authoritative professional guidance or standards exist for reporting audit findings. Auditors must develop their own standards in the process of their work and based on previous enforcement actions. An auditor cannot, however, guarantee a financial institution's compliance, and financial institutions should avoid any auditors that do so—*this is an examiner's red flag*. Qualified auditors should instead categorize the findings and observations as high, moderate, or low priority.

Individual financial institutions typically form their own standards for reporting on the adequacy of their compliance programs, bearing in mind their respective risk factors. A bank in Nebraska, for example, might determine that its program is adequate if 70 percent of the auditor's findings are low or moderate priority. A bank in Miami, however, might apply a more stringent standard because of risks associated with its location.

Regulatory Expectations

As the legal and regulatory environment has become more intense in recent years, examiners have raised their expectations for audits. Instead of being

satisfied merely that a financial institution's CTRs are completed, for example, examiners also delve into the accuracy of the information in the CTRs.

Likewise, examiners look beyond an auditor's job title. They expect competent and seasoned professionals with industry and audit experience. Examiners prefer working with auditors known to produce quality work and reports that can reasonably be relied on during their own examinations. As such, an inexperienced auditor can lead to greater scrutiny by examiners.

The Bottom Line

Financial institutions should not interpret the lack of professional standards for audit procedures, scope, and reporting as a sign that these factors matter little to examiners. Sound risk management practices, as well as regulatory expectations, require financial institutions to ensure they undergo quality audits performed by practitioners with expertise in accounting, auditing, and business processes and controls. **BC**

ABOUT THE AUTHORS

Paul R. Osborne is an executive with Crowe Horwath LLP in the Indianapolis office. Reached him at (317) 706-2601 or via e-mail at paul.osborne@crowehorwath.com.

Alan S. Abel is an executive with Crowe Horwath LLP in the Fort Lauderdale, Fla., office. Reach him at (954) 492-4411 or via e-mail at alan.abel@crowehorwath.com.